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Research on the Construction of a New-Type Bank-Enterprise Relation in China

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Abstract

Many Chinese enterprises face financing difficulties under current economic situation especially small and middle sized enterprises, the paper analyzes the problems of bank-enterprise relation in China, puts forward a new close bank-enterprise relation model that will benefit both banks and enterprise in reference to typical bank-enterprise relation models in the world, which is different from the host bank system in existence and the close bank-enterprise relation model prevails in western countries. The paper also gives some suggestions to construct such relation model.

Key words: Bank-enterprise relation in China; Long-term cooperation; New-type close bank-enterprise relation

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INTRODUCTION

The transaction relation between banks and enterprises short for bank-enterprise relation is a series of contract arrangement between them focus on enterprise financing activities, which is one of main economic relations in

market economy and has great influence on the running efficiency and stable development of the economy of a country.

At present, both banks and enterprises in China are caught in a dilemma, on one side, banks have too much fund they must pay a lot of interest but have great difficulties in lending, and on the other side, enterprises especially small and middle-sized enterprises (SMEs) get into financing trouble to the extent that they can't get enough capital for business operation. What on earth results in the problems between capital supply and demand and what results in the uneasy relation between banks and enterprises, we believe the answer is the serious information asymmetry between commercial banks and enterprises that has too many adverse effects on the banks' operation, so the paper puts forward a practical choice for the bank-enterprise relation model in China in consideration of the environment of banks and current situation of bank-enterprise relation.

1. CURRENT STATUS OF BANK-ENTERPRISE RELATION IN CHINA

The bank-enterprise relation in China has formed in the process of economic system changing from planning to market economy, so it has obvious features of economic reform. In planning economy time, the bank-enterprise relation was "supervise and being supervised" and "manager and being managed". Along with the establishment of market economy system, their relation began to change. At present, the bank-enterprise relation in China is similar to market contracting model, namely, both banks and enterprises are legal entities operate independently and associate with each other by transaction. However, the bank-enterprise relation in China also has some characteristics of non-marketing because of administrative intervention of government.

1.1 Enterprises are Very Weak in Credit Awareness and Credit Constraint Softening is Serious

Credit is the basis and soul of contract relation, however the phenomenon of losing honest and credit is very serious in China because banks and enterprises lack deep cooperation concept of interests interaction. Many Chinese enterprises open accounts in different names, get loans from different banks, and make every endeavor to avoid repaying banks' loans. On the other hand, it is difficult for banks to get true materials from enterprises to evaluate their credit, some banks complain that they even can't get real accounting statement from enterprises. At present, the main financing source in China is still indirect financing, some enterprises fabricate accounting statements and make backdoor deals in order to get banks' loan, which add their financing cost, together with high rate on borrowings and weak in profitability, repaying the principal and interest to banks put great burden on them, so the phenomenon of bank loans default can be found everywhere. The credit relation between banks and enterprises is softening constraint, but the banks' liabilities are hard constraint since they must pay their depositors' interests. The asymmetrical pattern of softening and hard constraint increases the risk of bank management and makes the bank-enterprise relation get into difficulty.

1.2 It is Difficult for Enterprises to Borrow and Banks to Lend

Since 1994, the gap between loans and deposits in Chinese financial institutions has increased gradually to a point that catches the attention of economists and policy makers. As a developing country with rapid economic development, China should not a country with surplus capital, but banks' difficulty in lending has been a serious problem that disturbs financial institutions. A large amount of deposit can't be lent out and deposit interest is rigid, which is especially adverse to the development of commercial banks because most of their profit comes from the margin gap between deposit and loan rate, for example, the gap of deposit and loan rate of Industrial and Commercial Bank of China contributed to 68% of its profit and that of China Construction Bank is 73.76% in the third quarter of 2011. However, most enterprises didn't think the conditions on their loans are looser and it is more difficult for them to get loans from banks on the contrary. The situation mentioned above is not the same for all enterprises, on one side, some enterprises that are supported by national policies with better market prospect become the object that several banks compete for and on the other hand serious shortage of funds restricted the development of SMEs.

1.3 Banks' Service is not Enough for Enterprises

Banks should provide full service for enterprises including loan, deposit, settlement, consultancy, and

so on, but according to existing loan credit system, secondary branches and sub-branches of banks can only provide services in accordance with stipulated lines of credit and variety, which is not in favor of developing all-round cooperation with enterprises. In addition, the establishment of market economy system hasn't real influence on the operation concept and strategy of commercial banks since they are still unaware of their status and function in the market economy, so the relation between banks and enterprises are not "provide service" and "accept service". Some banks think that enterprises need banks' support, sit back and wait for enterprises to drop in, as a result, they are in a passive status. Once problems occur on credit capital, banks always put blames on enterprises. When providing services to enterprises, banks always put forward many constraints and provide relatively less services.

2. THE CONSTRUCTION OF CLOSE BANK-ENTERPRISE RELATION

At present, there are three prevailing bank-enterprise relation models in the world, one is the market contract model represented by the United State established under mature market economy system and perfect legal environment, which is in favor of the development of banks, enterprises and the whole financial system. The other two are bank-dominated financial system represented by Japan and Germany that contributed greatly to the rapid development of them after World War Two. From the experience of above-mentioned three countries and the actual situation of Chinese financial market, we believe that China should establish close bank-enterprise relation model in reference to that of Japan and Germany, and simultaneously absorb the advantages of USA model, which is different from the host bank system of China in existence.

2.1 The Meaning of New-Type Bank-Enterprise Relation

The purpose to construct a new type host bank system is to improve current bank-enterprise relation and its meanings are as follow:

- (1) The host bank and the enterprise it provides service to combine with each other willingly according to the laws of market, they select mutually on the basis of credit without the administrative intervention of government.
- (2) The New host bank system is suitable for all banks and enterprises in spite of their ownership structure and scale, which can prevent banks' loan from concentrating on an industry or area excessively.
- (3) Banks' non-equity participation in enterprises' governance. Along with the reform of financial system, commercial banks and enterprises can hold shares of each other, for example, quite many shares of Bank of

Communications are held by enterprises, which can make the bank-enterprise relation more closely, improve economic strength and reinforce profit mechanism. However, when banks are both creditors and shareholders, if they are in favor of some enterprise, unfair competition will occur. So we think that banks and enterprises should keep respective independence and autonomy in the process of establishing socialist market economy, if they are combined closely by cross-shareholding, it is more difficult to eliminate the intervention of power economy.

(4) Banks and enterprises cooperate in the long run, which means an enterprise deals all its deposit, loan, settlement, information and consultancy business with one bank, namely its host bank to show all its private information to the bank, so that to solve the problem of information asymmetry.

2.2 The Benefits of New-Type Bank-Enterprise Relation

(1) It will do favor for banks to take part in corporate governance

As the biggest creditor of an enterprise, it is necessary and feasible for a bank to take part in its debtor's governance. We believe banks' participation in corporate governance has more advantages than disadvantages, it will help banks to find out the problems of enterprises as early as possible so that to take effective preventive measures. New-type bank-enterprise relation entitles banks contingent governance and proxy voting to reinforce them to participate enterprise governance. So that banks can take use of their advantages in talents, capital and facilities to protect their interests as creditors and obtain more profits simultaneously. So it is meaningful for both rationalizing bank-enterprise relation and improving enterprise governance.

(2) It will do favor to create relatively balanced information environment

After establishing long-term and all-round cooperation, the host bank can observe and supervise an enterprise during long time to accumulate more information. The enterprise will be willing to disclose its real financial status to the bank in order to get loan from it. So the host bank system can effectively solve the problems resulted from asymmetrical information and prevent enterprises from opening accounts in different names, getting loans from several banks and transferring capital to avoiding repaying bank loans. Relatively balanced information environment will be good for preventing credit risk, banks' pity on loans and local credit expansion. It will change banks' way in lending and improve the allocation efficiency of banks' capital.

(3) It will be favor for enterprises (especially SMEs) to solve the problem of difficulty in loans

The largest problem that a bank face in the process of loan approval is information asymmetry, if it chooses to increase loan pricing to compensate the risk that will make

the whole risk of existing clients increase and asset quality decrease. So a bank must evaluate a borrower's credit risk accurately so that to determine to lend or not, which needs the bank to know whole and real information of the enterprise's credit. The information communication is especially important for the enterprises lack of collateral. If an enterprise and a bank establish host relation, it can deal bill discount, fund settlement, staff salary payment, etc. with the bank so that to show its private information. Along with the bank knows more about it, the possibility of getting loan becomes more and more. Once it gets loan from the bank, its repayment records will gradually accumulate its credit history and an enterprise with good credit will become an object that a bank supports actively. After "credit" does good to an enterprise, it will commit to protect its credit in capital market and the long-term cooperation relation between them.

(4) It will be favor for enterprises to reduce borrowing cost

Commercial banks have the right to determine the interest rate of loans according to the range defined by the People's Bank of China and they will lend money to enterprises that have long-term cooperation at discounted rate due to following reasons. (a) Long-term cooperation between a bank and an enterprise will reduce the evaluation cost before lending because it has analyzed the enterprise's credit information and will save some evaluation expense in the process of loan approval. Since the bank has relatively surplus capital and market competition is intense, so it will reduce interest rate due to the expense saved. (b) Long-term cooperation between a bank and an enterprise will reduce the supervision times of the banks after lending. After an enterprise accumulates good credit history in the bank, the bank will gradually reduce supervision frequency, so the supervision cost after lending will reduce and the interest rate of lending will reduce accordingly. (c) All-round cooperation between a bank and an enterprise will reduce the interest rate of lending. If an enterprise deals all its bank business such as deposit, bill, settlement, electronic payment, and so on with its host bank, the bank will lending to it with discount rate considering profitable and competitive intermediary business.

3. SUGGESTIONS FOR CONSTRUCTING NEW-TYPE BANK-ENTERPRISE RELATION IN CHINA

Although the new-type bank-enterprise relation we propose has some advantages over former model, it can realize with three preconditions, the first one is enterprises can obtain necessary credit support and financial services from banks timely; the second one is the safety, liquidity and profitability of banks' loan can be guaranteed sufficiently; the third one is the relation are founded on

an equal and mutually beneficial basis. In order to realize above objects, we propose following suggestions from the views of government, banks and enterprises.

3.1 Construct and Perfect Social Credit System

The social credit system hasn't established completely in China without the punishment mechanism against dishonest behavior. So the construction and perfection of social credit system will strengthen the honest, self-protection and right guarding spirits of market entities (banks, government, enterprises and relative departments), and they will take part in supervising and resisting dishonest behaviors willingly. Credit information sharing will make dishonest behaviors be found anywhere, increase the social cost of faith-breaking people. Once an enterprise is blacklisted, it can't get loans from any bank. So banks and enterprises can take use of the credit information of social credit system to select honest partners and the enterprises with dishonest history will be abandoned by all banks.

3.2 Government Especially Local Government Should Transform Their Function

Government in different level should reduce their behaviors in intervening the decision-making of banks and enterprises. They should adopt effective measures to establish the communication channel between banks and enterprises, let them choose each other autonomously, and transform their function from management to service actually.

3.3 Enterprises Should Improve Their Quality

In essence, banks will only select enterprises that can make money for them. So Chinese enterprises must clear corporation property rights, establish modern enterprise management system, introduce advanced technology and high-quality talents to increase production efficiency and product quality so that to improve their core competition capacity and profitability.

3.4 Complete Related Laws and Regulations

The operation of new-type bank-enterprise relation needs equal and well-organized financial environment. Although the legislation in finance and banking develop rapidly in recent years, which establishes a basic frame for the development of finance industry, some articles of laws are out of times and the force of laws are not strong. For example, according to the revised PRC Enterprise Bankruptcy Law effective as of June 1, 2007, when an enterprise goes bankrupt, the debt it owns to its largest creditor-the bank is treated as ordinary debt without any priority over other creditors. The property of the bankrupt enterprise is first paid for bankrupt expenses, staff salary, labor insurance, statutory compensation and taxes unpaid in turn, the bank are repaid according to the debt ratio together with other creditors. Even if the loans are guaranteed with collaterals, it is possible for the bank that loses its priority due to various administrative intervention, which results in great losses of the largest creditor and its credit asset becomes bad account. A mountain of bad debts of China's big four banks are formed under such situation, and it is far away from solved radically. So the government has the responsibility to perfect legal environment and reinforces law enforcement.

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